

Internal Revenue Service
memorandum

FREV-111130-98

Br.6:FJZech

date: JUL 30 1998

to: Director, Employee Plans Division CP:E:EP
Attn: Berel Garherman

from: Chief, Branch 6 CC:EBEO:6
Office of the Associate Chief Counsel
(Employee Benefits and Exempt Organizations)

subject: Technical Assistance Request -
[REDACTED]

This is in response to your memorandum of May 11, 1998, requesting technical assistance with respect to the Taxpayer's ruling requests number (2), (3) and (4). Ruling request number (5) is within the jurisdiction of Branch 1 of EBEO, and will be the subject of a separate reply.

Taxpayer proposes to offer employers who purchase long term disability coverage (LTD Coverage), a [REDACTED] for the benefit of employees who are eligible to participate in a defined contribution plan of the employer, including plans with a 401(k) feature.

After a participant has been disabled continuously for the length of the elimination period, benefits would be payable from the [REDACTED] contract as premiums to fund a fixed nonqualified annuity contract, under which benefits would become payable at age 65. The purpose of the [REDACTED] is to allow employees who are disabled to continue to save for retirement.

The employer would elect to either have employees pay the entire premium for [REDACTED] coverage on an after-tax basis, or the employer would fund the entire benefit. Premiums would be available at group rates regardless of whether an employee electively participates in the plan. The amount of benefits payable under the [REDACTED] would be the same for all employees and would equal the employer's contributions under the defined contribution plan in the year in which the employee becomes disabled, or, if the plan is a profit-sharing plan and the employer did not make a contribution in the year of disability, an average contribution would be computed based on the amount of contributions for a number of years preceding disability.

If the defined contribution plan has a section 401(k) feature, the [REDACTED] benefit would be the sum of the averages of elective deferrals, after-tax contributions, matching contributions and profit-sharing contributions allocated to all participants in the year of disability, even if the employee does not electively defer or electively defers an amount higher than the average. Withdrawals may be made prior to age 65 subject to a penalty.

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Section 106 of the Internal Revenue Code (Code) provides that gross income of an employee does not include employer-provided coverage under an accident or health plan.

Section 1.105-5(a) of the Income Tax Regulations provides that an accident or health plan is an arrangement for the payment of amounts to employees in the event of personal injuries or sickness.

Section 105(e) of the Code provides that, for purposes of sections 104 and 105, amounts received under an accident or health plan for employees shall be treated as amounts received through accident or health insurance.

Section 105(a) of the Code provides that, except as provided in sections 105(b) and (c), amounts received by an employee through accident or health insurance for personal injuries or sickness shall be included in gross income to the extent such amounts are attributable to contributions by the employer which were not includible in the gross income of the employee, or are paid by the employer.

Section 104(a)(3) of the Code provides that, except in the case of amounts attributable to (and not in excess of) deductions allowed under section 213 (relating to medical, etc., expenses) for any prior taxable year, gross income does not include amounts received through accident insurance for personal injuries or sickness (other than amounts received by an employee, to the extent such amounts (A) are attributable to contributions by the employer which were not includible in the gross income of the employee, or (B) are paid by the employer).

Accordingly, based on the representations made and authorities cited above, we conclude as follows:

- (2) To the extent that premiums for the [REDACTED] coverage are paid by the employer, an employee's coverage under the [REDACTED] will be considered employer-provided coverage under an accident and health plan, and excludable from the employee's gross income under section 106 of the Code.
- (3) To the extent that premiums for the [REDACTED] coverage are paid by the employer, and excluded from the employee's gross income under section 106 of the Code, benefit payments under the [REDACTED] will be includible in the employee's gross income under section 105(a) of the Code for the employee's taxable year in which they are contributed to the nonqualified annuity contract.
- (4) To the extent that premiums for the [REDACTED] coverage are paid by the employee with after-tax monies, benefit payments under the [REDACTED] will be excludable

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from the employee's gross income under section 104(a)(3) of the Code when they are contributed to the nonqualified annuity contract.

If you have any questions or if we may be of additional assistance, please contact Felix Zech at 622-6080.


Harry Becker